Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at http://about.jstor.org/participate-jstor/individuals/early-journal-content.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

SECURITY PRICES AND THE WAR

By Roger W. Babson
Wellesley Hills, Massachusetts

As to the special problems likely to arise in the United States at the close of the European War with respect to security prices, I ask you to consider the following determining forces:

1. *The demand for securities,* which exists during periods of prosperity and which is especially potent in the early part of a period of prosperity. Such demand falls off as the period of prosperity develops.

2. *The supply of securities,* which accompanies a period of prosperity and which becomes especially great during the latter part of a period of prosperity.

3. *The attractiveness of securities,* from an investment point of view, depending both on the earnings of the corporations and the condition of the money market.

4. *The scale by which money is measured;*—that is, the abstract value of money—which depends largely, at the present time, on gold movements.

Of course there are other currents and cross-currents affecting the situation, but the allotted time will permit me to speak only of the above four. Moreover, for convenience I will subdivide this general subject of securities into three groups: namely, stocks, bonds, and commercial paper.

Stocks.—Statistics on bank clearings, new buildings, bank loans, foreign trade, railroad earnings, iron production, commodity prices, mercantile failures, and almost every other fundamental subject, clearly indicate that at the close of the European War we shall be at or near the close of the present period of prosperity. Therefore the *demand* for stocks should then be *less* than at the present time, and the *supply* of stocks should then be *greater* than is the case at present. This should especially be true of the stocks of new corporations which have been organized during the past three years, particularly those for handling war business.

As to the *attractiveness* of stocks from an investment point of view, after the war, opinions seem greatly to differ. Many honestly believe that the demand for steel, copper, and certain other raw materials will be even greater after the war than at present. I, however, do not hold this view. Personally, I believe that within twelve months

after the war there will be a decline of from 25 per cent to 50 per cent in the price of many commodities. History shows clearly that as soon as the price of a commodity declines buying at once falls off, and irrespective of current earnings of the company, prices for the company's securities decline likewise. People will not buy on declining markets, either commodities or stocks.

Gold movements do not have the marked effect on stock-market developments that is generally supposed. If the bringing of gold into the country inflates dividends, it likewise deflates the purchasing power of dividends. Therefore, inflation should directly make no difference in the selling price of the stocks. Indirectly, of course, the price of stocks is somewhat increased through gold inflation, as it is easier for speculators to borrow money during a period of heavy gold imports. If our gold movements after the war are as Mr. Roberts has so interestingly suggested, this should tend still further toward lower stock prices as peace is discounted.

Bonds.—The bond market after the war will be largely determined by what the foreign countries do concerning their present debt. If these nations default on these securities, or if Europe goes on a silver basis, then there will be an abnormal demand for the good bonds of neutral countries, especially bonds of corporations in the United States. In such a case, the prices of our good bonds should stiffen. If the war continues from two to three years longer, as some members of this Association insist, it is very possible that some of the nations will default on their securities, and certain countries go on a silver basis.

The most conservative bankers in New York assure me that the war will not continue any such length of time and that there will be no default of securities issued by the Allies. If this is so, there may be a tremendous demand for long-term money at the close of the war and fixed rates for long terms may rule about 5½ per cent. This would mean that bonds of corporations in this country would sell on approximately the same basis. If so, our bonds certainly would not go up in price for some time. Statistics seem to indicate that this will be the case, if we consider only "demand and supply" and their attractiveness as an investment.

When considering the effect of inflation on the bond market, there can be no argument. Continued inflation results in higher interest rates; hence in lower prices for outstanding bonds. Unlike stocks, the interest rates for bonds, already outstanding, cannot be adjusted to the inflation of the monetary standard. On the other hand, if in-

flation means lower bond prices, the deflation which we hear is likely to come after the war should mean higher bond prices. Personally, however, I feel that the amount of gold that will be exported or imported during the next few years will not materially affect bond prices. The future of taxable bond prices depends on what Europe is to do with her debt after the war is over. Concerning this, nobody knows.

Commercial Paper.—Again, assuming that business will begin to wane after the war, the *demand* for commercial paper should then increase, owing to idle funds in the banks; but the *supply* of commercial paper should decrease, owing to slackness of business. Concerning the attractiveness of commercial paper after the war, I think there will be no material difference compared with its attractiveness today. Good commercial paper is always attractive; poor commercial paper is never attractive. The price of commercial paper after the war will depend on demand and supply. Considering only such demand and supply, it looks as if commercial paper rates—after the war—would be lower than they are at present.

When considering our other factor, gold movements, this bears a very important relationship to the prices of commercial paper. Commercial paper is used by the banks to take care of their excess reserves. Commercial paper is the great shock absorber of the banking system. Most banks use commercial paper as a reserve fund. Hence, when trouble comes, they expect their commercial paper to be paid first of all. This is absolutely true of country banks and to a great extent of city banks. The gold imports which we have had during the past two years have tended toward an excess of money, which has resulted in a great demand for commercial paper, and consequently rates have been low. If heavy gold exports continue after the war, they should reduce the loaning power of the banks and curtail their purchasing power of commercial paper.

The ultimate result of all this will be, in my opinion, that after the war, the decreased lending power of the banks, due to gold exports, will just about offset their excess money, due to general slackness of business. Hence, the keenest buyers of commercial paper feel that rates on A-1 commercial paper will be practically the same after the war as at present. Of course, there will be ups and downs, and poor names may sell with greater difficulty; but there should be no marked changes for good paper.

A study of statistics, therefore, leads to the following conclusions relative to what is likely to arise in the United States at the close of the European War with respect to security prices:

1. Domestic stocks are likely to sell at very much lower prices as peace is discounted.

2. Domestic long-term taxable bonds will sell at lower prices if the war stops at once, but perhaps at higher prices if the war continues two or three years longer.

3. Barring some catastrophe, such as the United States becoming involved, rates for standard domestic commercial paper should continue after the war on about the same basis as during the war, with of course the usual seasonal variations.

One other factor which should be mentioned is the non-taxable feature of certain securities such as the new farm-loan bonds which are about to be issued. Bonds and other securities which are free from taxation, both as to income and principal, will continue to be in demand after the war and continue to sell at high prices on a low basis due to their nontaxable feature.